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C O N F I D E N T I A L SECTION 01 OF 03 TBILISI 002657

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TAGS: [ENRG](#) [EPET](#) [PREL](#) [GG](#) [RU](#) [AJ](#)
SUBJECT: GEORGIA'S NEW ENERGY MINISTER OUTLINES 2007-08
ENERGY SITUATION, CONCERNS ABOUT AIOC/AZERBAIJAN PSA
NEGOTIATIONS

REF: BAKU 1268

Classified By: Ambassador John F. Tefft, reason 1.4(b) and (d).

¶1. (C) Summary: The Ambassador met with Georgia's new Minister of Energy, Aleksandr Khetaguri, on October 18. Khetaguri outlined increasing hydroelectric production in Georgia that has enabled Georgia to export significant amounts of power to Russia, Turkey and Azerbaijan in 2007, as well as supply its domestic market. He estimates Georgia's demand for natural gas at 1.8-1.9 BCM annually. This demand will be met with modest amounts of gas received for transit to Turkey and Armenia, and a mix of Russian and Azeri gas. Because of its desire to limit the need for expensive Russian gas, Georgia is vitally interested in the AIOC-Azeri government negotiations over the ACG production sharing agreement and AIOC's recent decision to resume re-injecting ACG associated gas. Khetaguri said that Georgia will be unwilling to permit AIOC to ship additional amounts of oil that may be produced with the help of that re-injected gas. He said that Armenia's demand for Russian gas shipped through Georgia will not be reduced because of new Iranian supplies to Armenia until late in 2008. The GOG continues to work on plans for storage of natural gas. Nuclear power is a much more long-range possibility, Khetaguri said. End Summary.

¶2. (C) Khetaguri was a Deputy Minister of Energy from 2004-2006 after a long tenure with the Georgian National Electricity Regulatory Commission. In 2006, he became president of the Georgian Oil and Gas Corporation and ran it until he was appointed as Minister to replace Nika Gilauri, who was shifted to head the Ministry of Finance, in October ¶2007. He holds a bachelor's degree in computer science from Tbilisi State University and a Master's degree in accounting from the Tbilisi Business and Marketing Institute.

"PLENTY OF ELECTRICITY"

¶3. (C) Khetaguri said that in summer 2006 Georgia exported 800 million kilowatt hours (KWH) of electric power pursuant to swap agreements with Turkey, Azerbaijan and Russian utility RAO/UES. He expects to receive less this winter in return from Georgia's foreign partners, because Georgia will have "plenty of electricity". To the extent it is not compensated in kind, Georgia will receive cash, he said. Khetaguri was pleased that in 2007, Georgia provided some 300 million KWH of electricity to Russian utility RAO/UES worth USD 12 million. The new exchange deal with Russia, which returns power kilowatt for kilowatt, or for cash, is similar to a deal in place with Turkey. This swap deal continues through 2009. Khetaguri sees it as unfortunate that Gazprom and RAO/UES "hate each other," making a gas for electricity

swap with Russia impossible. Khetaguri reported that Georgia is exploring a power swap deal with Azerbaijan that would see summer hydropower from Georgia exchanged for winter gas. Such a deal is supported by both nations, but Khetaguri laments that it cannot be concluded until Azeri production meets internal demands, which means at the earliest 2009.

¶4. (C) Water levels at the Enguri and other hydroelectric dams are at historically high levels, Khetaguri said. Rehabilitation of the second generating unit at Enguri is finished, which will increase Enguri's capacity by 160-170 megawatts (MW) with a lower risk of failure due to improved infrastructure. Work is proceeding on the third of Enguri's five units, which will further increase the capacity at Georgia's largest source of electricity as each of these new repairs comes on line (one year is required to complete works on each). Comment: For the first time in decades Georgia can fully exploit Enguri for its intended purpose: to provide peaking power that complements Georgia's base-load thermal and hydropower assets.

¶5. (C) Thermal electrical generation capacity is the same, that is, Gardabani unit 9, run by RAO/UES subsidiary Mtkvari Energy (capacity 250 MW), state-owned units 3 and 4 (130 and 140 MW respectively) and EnergyInvest's gas turbines (two units, capacity 55 MW each). Unit 9 is forecast to run from the end of September to the end of March and Unit 3 from mid-November to mid-March. Unit 4, which Khetaguri hopes will not be used, is being readied for a maximum of one month mid-December to mid-January if needed. The gas turbines are being "held in reserve," at very high cost to the network. They will operate only as needed, Khetaguri said.

AIOC/AZERI DISPUTE CAUSES CONCERN

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¶6. (C) Khetaguri said that demand for natural gas this winter will not vary much from last year. He estimates Georgia's total natural gas consumption for 2008 to be 1.85 billion cubic meters (BCM), down from over two BCM forecast for 2007. The reduction is due in part to more rational use of power generation capacity that minimizes high-cost thermal generation. Gas demands will be met by 0.2 BCM received from Russia for transit of gas to Armenia, 0.25 BCM from South Caspian Pipeline (SCP) gas from the Shah Deniz field in Azerbaijan, and the rest from a mix of Azeri and Russian gas. Comment: Imports of electricity that could offset gas imports are missing from the 2008 Georgian electricity balance, principally because Georgia is unwilling to rely on Russia for electrical energy as well as natural gas. It is also unwilling to turn to Armenia because its Armenian generating assets are Russian-owned.

¶7. (C) The amount and price of gas to be received from Azerbaijan and Russia are currently unknown beyond existing contracts for \$235/tcm from Russia which expire December 31. Obtaining greater quantities of Azeri gas is the subject of negotiations that are currently stalled as Azerbaijan ironed out differences with BP and the BTC consortium AOIC over future production of oil and gas from the ACG and Shah Deniz fields (reftel). Khetaguri said that Azerbaijan had promised Georgia one BCM in 2008, but that discussions were halted when the Azerbaijan-AIOC negotiations went off the rails. Currently, no deliveries of gas are being received, but the Azeris have confirmed they will supply 1.3 million cubic meters daily until January (out of Georgia's approximately 8.3 million cubic meter peak demand in mid-winter).

¶8. (C) Khetaguri explained to us that AIOC is contractually obligated to deliver 1.4 BCM of gas to Azerbaijan from the ACG field. He said that ACG gas production has exceeded the 2 BCM previously estimated and should total 4 BCM per annum. This implies that AIOC now has 2.6 BCM to reinject or sell to Azerbaijan - significantly more gas than the previously

forecasted 0.6 BCM. Last year, as delays in gas production from Shah Deniz occurred, AIOC had agreed with SOCAR to reduce the amount of gas reinjected into ACG and supply an additional 1.6 BCM to Azerbaijan, some of which was sold to Georgia to reduce its dependence on Russian gas. Now, with SCP up and running, Khetaguri said that AIOC wants to reinject the entire 2.4 BCM to produce greater-than-planned amounts of oil and reap profits from the current high world prices for oil. When negotiations on ACG's future broke down, AIOC stopped supplying the additional 1.6 BCM to Azerbaijan, supplying only the 1.4 BCM contracted volume. Khetaguri estimates that as a result, Azerbaijan will have a shortfall in its total needs of 500-600 million cubic meters.

19. (C) If the Azeris cannot convince AIOC to increase the amount of ACG gas supplied, and if they want to remain free of any Russian gas imports, they will have to burn more expensive mazout than planned or cut supplies to Georgia. Both Khetaguri and Georgian Prime Minister Noghaideli want to avoid the latter outcome. Khetaguri said that Georgia holds a card in the AIOC-Azeri discussions -- AIOC needs Georgia's permission to increase BTC shipments beyond those already contracted. Khetaguri admits that the consortium is not immediately obligated to supply the reinjected gas to Azerbaijan, but if AIOC reinjects the gas into the ACG field to increase oil production, it will not have any way to ship that oil to market without Georgia's and Azerbaijan's cooperation. It is this threat to which PM Noghaideli was referring in his most recent conversation with the Ambassador, and as clarified by Khetaguri, it does not seem to involve repudiating agreements or cutting off shipments to which the GOG has already agreed. Khetaguri said that he has met and exchanged views on this issue with Georgia BP Chief Hugh McDowell. Comment: Under the scenario as explained by Khetaguri, the best outcome of the AIOC-Azeri negotiations would seem to be a compromise under which some gas is reinjected, some more oil is produced and shipped via BTC, and some gas is supplied to Azerbaijan and Georgia. Both BP and Khetaguri believe that Azerbaijan will have to burn mazout for power in 2008, because even the additional 1.6 BCM is not enough to meet Azeri demand, let alone export gas to Georgia.

ARMENIAN DEMAND FOR IRANIAN GAS

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110. (C) The Ambassador asked Khetaguri his impressions of the gas supply to Armenia from Iran, as the new Iran pipeline comes into operation. Khetaguri said that he understands from personal review of the Armenian gas balance that Armenia does not intend to reduce Russian gas imports until the end of 2008, implying there will be no real increase in supply to Armenia from Iran before then. Therefore, he expects there will be no decrease in transit gas for Georgia from the North-South pipeline until that time. As for Georgia's dealings with Iran on energy, Khetaguri said there have been no government-to-government negotiations since 2006. He denied that KazTransGaz is negotiating with Iran for supplies.

THE FUTURE: MORE DIVERSITY, LESS RUSSIAN GAS

111. (C) Looking to the future, Khetaguri said that the next two to three years will be critical for both Georgia and Azerbaijan in terms of supplying their needs for natural gas. After that, Georgia will need much less Russian gas as its transit fee for Shah Deniz gas trends up to a maximum of 0.8 BCM per year. In the short term, he said, gas which AIOC had intended to reinject to boost oil production will be needed. Khetaguri reiterated the GOG's willingness to "turn the screws" on AIOC to get its way. The GOG is proceeding with feasibility studies for gas storage facilities, and has

discussed obtaining financing for them from the Azeri government. The options include a small (0.5 BCM) but inexpensive facility at Rustavi, and/or a larger (up to 5 BCM) facility at Ninotsminda which would cost \$60 million for the first, 400-500 million cubic meter stage alone. He also sees a need for more gas storage in both Turkey and Azerbaijan. Khetaguri said that nuclear power is something the GOG is considering, but he sees it as something a long way off.

TEFFT